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Preconditions and Prospects for Banking Integration in the Eurasian Economic Community

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7 Preconditions and Prospects for Banking Integration in the Eurasian Economic Community

Regional economic integration in the EurAsEC member countries is increasingly often considered by academics from the point of view of cooperation in trade and investment. Much less attention is paid to the activities of banking intermediaries which fund these operations. The expansion and strengthening of cooperation in the region is accompanied by a growing demand for banking services. In the 1990s, cross-border banking operations were practically the only international system available. In the past few years, financial organisations have set up networks in EurAsEC member countries to service their regular clients, whose economic interests extend beyond national economic boundaries.

The development of mutual cooperation between their banking systems includes a commitment by EurAsEC member countries to create an integrated financial market as part of the regional bloc, in line with the EurAsEC member countries' Blueprint for Monetary Cooperation. Given this situation it becomes expedient to examine the level of banking interaction in the member countries and identify existing preconditions for the creation of a single banking and financial services market.

THE CHARACTERISTICS OF BANKING SYSTEMS IN EURASEC MEMBER COUNTRIES

Although the development of banking systems in EurAsEC member countries (and in the entire post-Soviet space) has been successful in many ways, it is nevertheless not without certain persistent problems.

The banking systems of EurAsEC member countries have evolved significantly over the past 15 years. In particular, market reforms in the banking sphere have established two-tier banking systems and the legal framework for central banks and financial institutions. Financial institutions have been increasing their capitalisation in the EurAsEC member countries in recent years. In 2006 alone, their combined assets increased by over 60%.

Some member countries have switched to International Financial Reporting Standards, which are seen to facilitate risk-assessment and increase the transparency of banking operations. Banking regulation is largely conducted in line with international standards. Following recommendations from the Basel Committee on Banking Supervision,

most member countries have increased the minimum size of authorized capital to €5m, thus providing the increase of the capitalisation of financial institutions. Some countries have adopted deposit guarantee scheme, which is, of course, a significant step forward in the evolution of banking systems.

Another positive trend concerns the growing transparency of the national banking systems and the increasing role of foreign capital, which have helped to boost competition in the market and improve standards in banking. IPOs by Russian and Kazakh banks have become more common in recent years.

Nevertheless, despite considerable improvement in EurAsEC member countries' banking systems, regional banking markets are quite poorly integrated and differ widely in terms of the structure and size of their operations. For example, the combined assets of all EurAsEC banking systems stood at \$625 billion as at 1 January 2007. Moreover, these assets **are distributed unevenly between EurAsEC member countries**: Russia accounts for over 85% of the total assets. The second biggest banking system – Kazakhstan – accounts for about 11%. Belarus and Uzbekistan account for 2% and 1% respectively, while the Kyrgyz and Tajik banking systems' combined share is less than 1%¹.

A considerable concentration of banking assets is also apparent within national banking systems. Most assets and capital are shared by a limited number of financial organisations, which in Soviet times were, most often, regional branches of Sberbank or Vneshtorgbank. For example, Uzbekistan's National Bank of Foreign Economic Activity accounts for 70% of the country's total banking assets.

Despite quite high growth rates in banking assets in the six countries, their **role in servicing the economy is still insignificant**. The coefficient of financial intermediation, calculated as the ratio of assets to GDP, is extremely low in most of the countries in comparison both to developed and developing countries (Table 1). The role of the banking system is greatest in Kazakhstan where assets account for 86% of GDP.

	Russia	Belarus	Kazakhstan	Uzbekistan	Kyrgyzstan	Tajikistan
Number of banks	1189	28	33	28	21	15*
Assets, billion dollars	533.4	13.6	69.9	5.8	0.7	0.6**
Capital, billion dollars	64.3	2.4	9.2	0.9	0.1	0.1**
Assets/GDP	54.2	36.8	86.3	34.1	24.8	21.4

TABLE 7.1
Banking sector
indicators in EurAsEC
member countries as at
1 January 2007

Source: *Interfax-1000: Banks of CIS Countries, 2006; World Economic Outlook Database, October 2007*

* Excluding non-banking organisations and micro-credit institutions

** As at 1 April 2007

¹ *Interfax-1000: Banks of CIS Countries, 2006*

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The limited role of banking systems in the economies of the EurAsEC member countries makes them considerably **dependent on global financial markets**. Around half of all loans in Russia are issued by foreign banks. Cross-border loans now constitute as much as 52% of the liabilities of Kazakh banks². The Kazakh banking system suffered the adverse impact of this dependency in 2007 when, owing to the US sub-prime mortgage crisis and the liquidity crunch that followed it, ratings agencies downgraded Kazakhstan's sovereign rating. This was prompted by the anticipation of liquidity shortfalls for Kazakh banks which have debt liabilities of around \$10 billion.

The structure of each EurAsEC member's banking system has a significant impact on its development. The role of state capital is still quite high in some member countries. For example, state-owned banks account for over 70% of total banking assets in Belarus, 44.6% in Russia and more than 90% in Uzbekistan where the banking system is least transparent. This high proportion of state capital affects the banks' ability to perform their financial intermediation function and distorts competition. Many state-owned banks enjoy preferential status in connection with state-funded projects, and major state-run enterprises hold their accounts in these banks. State-owned banks also rely on government support in times of difficulty.

Despite the significant development of these **banking systems**, they **remain highly vulnerable**. According to international ratings agencies, risks in the CIS banking system are among the highest in the world, due to the existence of the grey economy, the considerable debt liabilities of financial organisations, widespread distrust of banks, the poor quality of loan portfolios and the existence of "protected" banks.

There is no doubt that the banking systems of EurAsEC member countries **are at different stages of development**. Kazakh and Russian banking systems are playing a significant role in this region. However, the banking systems of the member countries are highly disparate and there is huge variance in their scale, structure, extent of operations and level of development.

INTERSTATE COOPERATION IN BANKING SPHERE

"Formal" interaction within the banking sector is one of the financial integration initiatives formulated in 2004 by the heads of state of five EurAsEC members. In identifying priorities for EurAsEC development in 2003-2006 and beyond, the heads of state highlighted the creation of a common financial market as a key cooperation priority.

Plans to create a common financial market within EurAsEC were incorporated in 2005 in the member countries' draft blueprint for cooperation in the monetary sphere. The blueprint included proposals

² Kazakh banks' high dependence on global capital markets is particularly noticeable in the global liquidity squeeze, *Standard & Poor's*, 2007.

for cooperation within the monetary, credit and financial sectors and envisaged the step-by-step creation of a common financial market. The first stage (2005-2007) was aimed at bringing the banking legislation of EurAsEC member countries in line with the Basel Core Principles for Effective Banking Supervision; creating conditions for free access to national financial markets for legal entity residents in the member countries; and concluding bilateral agreements on the establishment of national treatment.

The second stage (in 2007-2010) envisages the unification of financial, banking and monetary legislation.

The third stage (from 2010) should see the creation of a common financial market and ensure free capital movement.

The success of this plan to create a common financial market largely depends on the extent of regional banking cooperation. Close cooperation in the sector creates the basis of national financial systems and may help to strengthen and accelerate the formal process of economic integration.

In general, a common financial market can only function when certain institutional, quantitative and pricing conditions are met. The first of these is the abolition of restrictions on the capital movement. Secondly, a fair and equal business environment must exist for financial organisations setting up foreign branches and offering cross-border services. Thirdly, consumers must have free access to services within the regional financial market.

The present parameters of national banking markets can be quantitatively assessed by analysing the level of mutual provision and consumption of financial services through cross-border operations and subsidiaries in local markets, and price differentiation. Institutional reviews consider existing restrictions on service providers' and users' mutual access to one another's markets.

RESTRICTIONS ON EQUAL ACCESS FOR MARKET PLAYERS. When post-Soviet countries gained independence, local banks became foreign to one another. As a rule, **the national legislation of EurAsEC member countries and bilateral and multilateral agreements between them do not establish preferential banking regulations for owners of banks who originate from EurAsEC countries, despite the declared objectives of regional integration.** Therefore banking entrepreneurs from EurAsEC member countries are treated like shareholders from any other foreign country.

Most favoured nation treatment (MFN) is now granted to bank founders from EurAsEC member countries, as it is to other non-resident shareholders, but MFN allows to apply restrictions for foreign financial organisations. These include exemption from national treatment, and thereby create different conditions for domestic and foreign financial organisations, including those from EurAsEC member countries.

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These restrictions include limits on aggregate ownership by non-residents, certain stipulations regarding staffing policies and a ban on the use of certain administrative and contractual business practices.

The most common exemption from national treatment is the imposition of a quota on foreign capital. It used to be applied in almost all EurAsEC member countries and varied from 12% of total banking authorized capital in Russia, to 50% in Kazakhstan (and was also applied to capital from EurAsEC member countries). However, member countries have been abolishing quantitative restrictions as part of a policy to liberalise access for foreign banks. This limit is still applied in Belarus, where non-residents do not have the right to own more than 25% of the total authorized capital of the banking system.

CIS countries are still imposing restrictions on the staffing policies of banks with foreign ownership. These apply both to bank management and ordinary staff members. For example, Russian legislation demands that at least 50% of managers of a foreign bank should be Russian citizens, because they are better acquainted with the specific banking conditions of the national market. At least 75% of employees of any bank with foreign investment must be Russian citizens.

In some countries legislation limits competition between foreign and local banks by applying restrictions on the opening of accounts by legal entities. In Belarus, for example, a legal entity has the right to open an account only in one bank. As a result, an enterprise is denied the opportunity to try other banks and will almost never opt to transfer its accounts to another bank.

Also exempt from national treatment are those measures which prevent foreign banks exploiting all available forms of service provision. The most widespread restriction is a ban on the opening of new branches as a means of expansion. A branch of a non-resident bank is not an independent legal entity or resident, therefore its activities are regulated by the laws of the country of origin of the parent bank. Russia, Kazakhstan, Belarus and Uzbekistan do not allow non-resident banks to open branches.

The policy of some countries regarding branch banking services has changed. For example, a branch of an Iranian bank has been set up in Tajikistan. The liberalisation of access to Kyrgyzstan's banking system as a result of the country's accession to the WTO has allowed the National Bank of Pakistan to open a branch there.

In addition to the existing legislative restrictions on mutual access for market players, post-Soviet countries may also use administrative measures and adopt a selective approach in relation to foreign investors. This applies particularly to mergers and acquisitions. However, it is fair to say that, since buyouts of existing banks in the EurAsEC are few in number, these operations are subject to fewer administrative restrictions than they tend to be in other sectors of the economy.

In addition, the current inaccessibility of some banking systems (Tajikistan, Belarus and Uzbekistan) to foreign investors is a considerable obstacle to the integration of markets within the EurAsEC.

The openness of national banking systems has increased immensely in the past few years. Generally, however, the liberalisation of access for foreign capital has taken place not under the auspices of the EurAsEC but as the result of national banking systems' integration into the global financial market and their preparation for WTO membership.

One of the few documents which EurAsEC member countries have adopted which does give preference to its own banking systems concerns resident bank access to currency markets of EurAsEC countries. Although member countries have ratified this agreement, no specific steps have been taken for its realization. Moreover, there are doubts about how successfully such measures could be implemented in some countries since, according to Paragraph 44 of this document, priority is given to obligations under other international treaties.

We believe that, from the point of view of legislating for cooperation in banking, it is still too soon to focus on the existence of tangible preconditions for the creation of an integrated market. Existing national legislation can only confer most favoured nation treatment, while the modern trend of reducing exemption from national treatment and encouraging banking interactivity is mainly connected with the integration of banking systems into the global market, rather than with one another. Moreover, the accessibility of national banking systems differs widely and, therefore, existing regulatory systems governing banking activity have not been harmonised.

These disparities in the regulation of financial institutions create serious obstacles to their integration. It is possible that cooperation will increase in the future, for example, through unilateral access for EurAsEC member country banks to various sectors of the financial market, but this cooperation will be somewhat asymmetric in nature.

THE SCALE OF BANK PARTICIPATION IN EURASEC. EurAsEC member country banks have been actively penetrating each other's markets in the past few years. In 2007, banks' investments in the authorized capital of the banking sector stood at \$522 million, with total assets for controlled financial organisations standing at more than \$3.8 billion. The investment of EurAsEC member country banks in each other's authorized capital had doubled since 2005. This significant growth was facilitated mainly by an increase in the size of these banks' subsidiary branches rather than by the establishment of new financial organisations.

The entry of EurAsEC banks into foreign markets has been fairly characteristic. Firstly, until recently, their foreign activities tended to be one-off ventures, whereas now **regional banks have emerged whose development strategies involve expansion into post-Soviet countries** (for example, Kazakhstan's BTA Bank)³. Secondly, there have

³ It should be noted that Vneshtorgbank has also developed its regional development strategy and focuses its activities in Ukraine and Caucasian countries, and still does not have a single branch in the EurAsEC member countries. However, it plans to finalise a deal to integrate Belarus's Slavneftebank into the VTB Group.

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been many cases of banks in the EurAsEC being purchased by but not integrating with parent companies, continuing instead to operate under existing brands⁴. For example, BTA Bank has several subsidiaries in Russia which did not change their brands after BTA replaced their shareholders. Thirdly, EurAsEC member country banks have **asymmetric involvement in each other's markets**. Russian and Kazakh banks have the greatest competitive advantage. In addition, banks in these countries **concentrate their foreign banking assets in very few countries**. For example, Kazakh banks have prioritized partnerships within the EurAsEC (Russia and Kyrgyzstan), while Russia's main banking assets are in Belarus and outside the EurAsEC (namely, in Ukraine).

We have counted at least 13 banks in EurAsEC member countries which are expanding within the community (by comparison, there 24 such banks in the CIS). Usually, **the greatest presence of foreign assets is in the form of a small number of leading banks**, while other banks have only one branch in the region. For example, four Kazakh banks – BTA, Kazkommertsbank, ATF Bank and Halyk Bank – account for 75% of total investment in the authorized capital of banks in EurAsEC member countries. BTA has four subsidiary branches in Russia and one each in Belarus and Kyrgyzstan. The other three Kazakh banks each have one branch in Russia and one in Kyrgyzstan.

Russian banks are the main foreign banking presence in Belarus, where there are subsidiaries of Gazprombank, Bank of Moscow, Rosbank and others. In 2007, the role of Russian banks in the Belarusian banking system grew as a result of several acquisitions. For example, Belvnesheconombank was bought out by Vneshtorgbank, while Mezhtorgbank was taken over by Alfa Bank. Ownership of Slavneftebank, formerly controlled by a Russian oil company, will also be transferred to Russia's Vneshtorgbank.

The Kazakh banking system, which is the second largest in the EurAsEC, has seen less inward investment by Russian and other EurAsEC banks. For some time, only Alfa Bank had a presence in the Kazakh market. However, Sberbank recently moved into Kazakhstan through its purchase of Texakabank, which in turn owns Russia's Metrobank, a retail banking specialist.

Several Russian banks – Renaissance Capital, for example – are operating in Tajikistan. Russian shareholders are present in Kyrgyzstan only as minority owners.

With regard to other EurAsEC countries, a major Uzbek bank – Asia-Invest – has one branch in Russia. Banks in Kyrgyzstan, Tajikistan and Belarus have not expanded into foreign markets, partly due to the relatively small size of their banking systems.

Despite the quite high concentration of foreign assets held by certain banks, **foreign markets are not the primary target of these financial organisations** (Figure 1).

⁴ Buzdalin A. (2006) *CIS Banks Increasing Presence in CIS*, *Kommersant Bank*, 21 September.

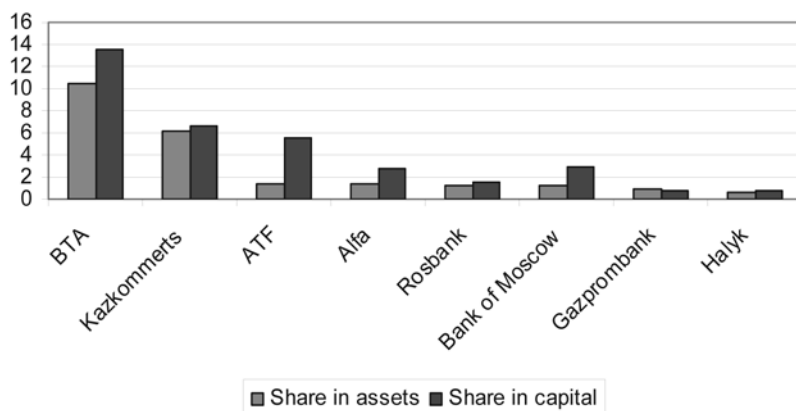


FIGURE 7.1
Foreign network in
EurAsEC as a share
of bank's assets and
capital at the beginning
of 2007, %

This graph shows Kazakh banks have the most significant foreign banking operations. For example, more than 10% of BTA Bank's assets and 14% of its capital are in EurAsEC countries. However, it should be noted that most banks which are expanding abroad either set up or buy small banks which account for an insignificant share in the country's total banking assets.

Subsidiary banks in the EurAsEC are playing a negligible role in national banking systems. Banks from EurAsEC countries are a significant foreign presence only in certain countries. For example, Kazakh banks are the most active banks in Kyrgyzstan and they have bought several Kyrgyz banks. As a result, the share of EurAsEC banks in the total capital of the Kyrgyz banking system exceeds 30% (Figure 2).

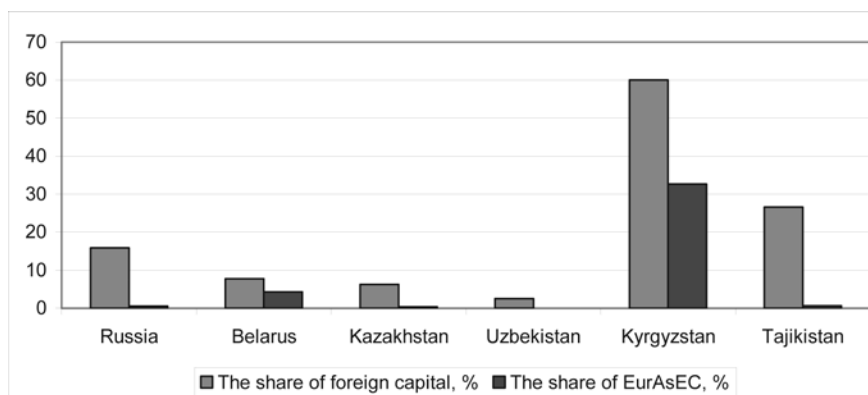


Figure 7.2
Share of foreign capital,
including from EurAsEC
member countries, in
the banking system, %

The graph shows that foreign capital is a dominant presence in the banking system only in Kyrgyzstan, while its role in other EurAsEC countries is minimal.

In general, the level of mutual involvement of EurAsEC banks is slowly growing, but relative indicators are still low. For example, the

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share of EurAsEC bank subsidiaries in the total assets of the EurAsEC banking system does not even reach 1% (whereas it stands at 1.2% in the CIS and 17% in the EU).

Banking interaction indicates to a certain extent the development of economic relations between countries, while asymmetric involvement of banks is often explained by the absence of significant bilateral economic cooperation. Furthermore, the low capitalisation of EurAsEC banks and the continuing high risk of banking activities are tangible obstacles to the development of foreign banking activities.

Banks usually expand into foreign markets to service their traditional clients and their trade and investment operations. This strategy is called "follow the client", which means that banks create branches only in those countries where they have clients. This motivation for foreign expansion is typical in the initial stages of the transnationalization of banking and is now affecting EurAsEC member countries.

This thesis is borne out by analysis of the correlation between Russian and Kazakh banks' penetration in EurAsEC member countries and trade relations in the region. There is a high interdependency in the expansion of trade and banking capital. For example, the correlation coefficient between banks' investments and the country's trade with the EurAsEC countries is about 0.99 for Kazakhstan and 0.89 for Russia, indicating high direct dependence. However, this correlation for CIS countries is lower (0.98 and 0.77 for Kazakhstan and Russia respectively). As a result, Russian and Kazakh banks' expansion in the EurAsEC is proportional to the level of bilateral trade.

However, there is not necessarily an economic imperative behind every bank's foreign investments. Russian banks' very limited involvement in Kazakhstan serves as a good example of this. Despite the extensive trade relations between Kazakhstan and Russian, economic cooperation is mainly in the form of cross-border transactions. Kazakhstan accounts for the bulk of correspondent accounts opened by Russian banks in the post-Soviet space.

The volume of banking operations between the EurAsEC countries is currently growing at lower rates compared to the growth of assets in the banking system. That is why investment between banks is minimal and cannot be a precondition for the creation of an integrated regional financial market. Moreover, banking cooperation is developing asymmetrically and the level of unilateral integration of some countries (for example, Kyrgyzstan) into the regional banking services market is quite high.

PRICE DIFFERENTIAL. One precondition for creating an integrated banking services market is the harmonised cost of loans, which results from competition in national and regional markets.

Certain standardisation in the cost of loans can be established by the dynamics of the interest rates on loans issued to non-financial sector and estimations of their fluctuations (Figure 3).

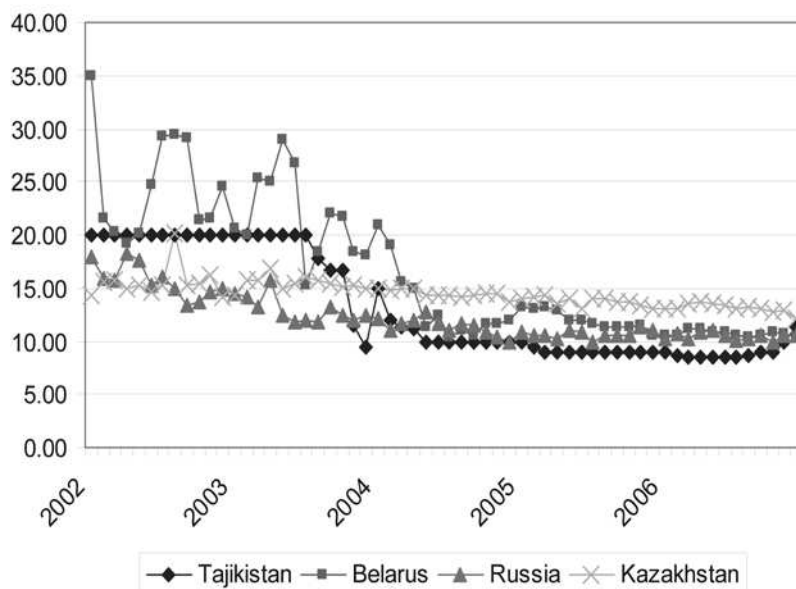


FIGURE 7.3
The dynamics of
monthly interest rates
on loans issued to
non-financial sector in
EurAsEC countries

Source: Central banks
of the EurAsEC member
countries

The graph shows that interest rates on loans issued to non-financial sector have stabilised to a degree since 2004, and that they have fallen somewhat in the past five years. At the same time, interest rate fluctuations are quite small in Russia and Kazakhstan, but a little greater in Tajikistan and Belarus.

Another indicator which allows us to assess price differential in the EurAsEC member countries is the dynamic of the banks' margins between interest rates on loans and deposits (Table 2).

	2000	2001	2002	2003	2004	2005	2006
Беларусь	30.1	12.8	10.0	6.6	4.2	2.2	1.1
Кыргызстан	33.5	24.8	18.9	14.1	22.6	20.8	17.6
Россия	17.92	13.06	10.75	8.5	7.61	6.69	6.41
Таджикистан	24.33	15.86	4.99	6.9	10.57	13.52	14.17

TABLE 7.2
Interest rate margin
in EurAsEC member
countries

Source: *International
Financial Statistics*,
2007, October

The dynamics of the banks' margin in EurAsEC countries point to an insignificant convergence in its rates. Banking margin is relatively high in Kyrgyzstan and Tajikistan because of weak competition in their markets and the poor development of their banking systems. Vernikov (2006) believes that significant differences in money circulation parameters are due to the small amount of capital moving between post-Soviet countries⁵. Thus, according to price parameter financial markets of EurAsEC member countries are quite divergent.

The prospects of creation of integrated financial market. In principle, the prospects for cooperation between the banking systems of the EurAsEC member countries are very favourable. The increase in banks'

⁵ Vernikov A. (2006) *Multinational Banks in CIS*. Published in a collection of articles, entitled "Contradiction of processes of currency and financial integration in CIS", Moscow.

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penetration of each others' markets confirms that banking cooperation between countries has increased and this is an indirect indicator of a growth in trade and investment between them. Integration "from the bottom up", i.e., by the increase in cooperation between business structures, normally signals to the authorities that they should create favourable institutional foundations to encourage cooperation. However, the region's countries have not yet created the framework for attracting banking capital from EurAsEC member countries because there are often institutional restrictions to this. The market's infrastructure has not developed to the degree that is necessary in order to boost cooperation in the banking sphere.

Currently, banking systems are developing by integrating into the global, rather than into the regional banking services market. This has a dual impact on mutual cooperation within the EurAsEC. On the one hand, it facilitates the liberalisation and harmonisation of banking regulations necessary for creating an integrated banking services market. On the other hand, global financial markets are diverting the banks' focus away from regional cooperation.

A further substantial obstacle to cooperation is the expected takeover by Western financial organisations of EurAsEC banks which are expanding into neighbouring markets. For example, Kazakhstan's ATF Bank, which has branches in Russia and Kyrgyzstan, was taken over by the Italian UniCredit Group in 2007. We believe that BTA Bank is also a likely takeover target for a Western bank.

The fact that integration initiatives in the former Soviet space have stalled is further hindrance to the formation of a common policy for the banking sector. In such conditions, a paradox emerges: integration is delayed, but business interaction has been growing. We believe this is because the facilitation of bilateral and multilateral banking cooperation is not the key factor in ensuring the growth of this cooperation.

The promotion of investment and trade and relative stability in the national banking systems, the competitive advantage of major banks in less developed EurAsEC banking markets and prospects for economic growth all play a huge role in developing banking cooperation. In the future, cross-border operations and the establishment of regional networks, including through takeovers, will increase banking cooperation in the former Soviet space. Major Kazakh and Russian banks that wish to become regional banks with network in all CIS countries will make the greatest contribution to the development of banking cooperation.

It is possible that the future model for cooperation in the CIS will be based on the spheres of influence of Russian and Kazakh capital. For example, Russian interests will not be focused in countries that belong to a certain supra-national integration organisation but in the European countries of the CIS (Ukraine, Belarus and Moldova). Central Asia will be Kazakhstan's sphere of influence, while the Caucasus will fall into the spheres of influence of both Russia and Kazakhstan (Figure 4).



FIGURE 7.4
The spheres of influence
of Russian and Kazakh
banking capital

However, this development model does not preclude the presence of Russian banks in Kyrgyzstan or Tajikistan, for example. It envisages that Kazakh capital will play a dominant role in the banking systems of these countries.

It is also expected that banking cooperation will develop mostly on a bilateral basis. For example, Russia's financial cooperation with Belarus and Ukraine will increase (even though the latter is not member of the EurAsEC). Since domestic financial markets are not well developed, it is expected that stock-market players as well as banks will be implicated in the cooperation process. For instance, Russian banks will help Belarusian and Ukrainian companies enter the Russian stock market.

Kazakhstan is also adopting a similar strategy and has set up a regional financial centre in Almaty (RFCA) based on the Kazakh Stock Exchange (KASE). The RFCA's major advantage is its international status, which allows foreign issuers and investors to enter the market. It is anticipated, for example, that a list of potential issuers of the RFCA will include large- and medium-sized Kazakh companies and medium-sized Russian, Ukrainian and Central Asian enterprises.

The pursuit of formal integration through the creation of an integrated financial market and the abolition of restrictions is being addressed in two ways. The 2005 blueprint for cooperation between EurAsEC member

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countries in the monetary sphere involves measures relating to financial and banking cooperation. The three-stage implementation of this blueprint will result in the abolition of restrictions on the movement of capital and the harmonisation of banking legislation. However, this will fall short of creating a fully integrated (i.e. reciprocally linked) financial market.

Adopting similar standards for the activities of banks and financial organisations will not encourage markets to converge and will not eradicate disparities. A possible outcome of this blueprint will be the uneven development of national markets with similar standards and the absence of restrictions on the movement of capital, but it is very likely that the deficient development of local banking services markets will persist. Domestic demands for a common financial market are not sufficient, but the system should not be imposed by external authority, since the integration process results logically in financial integration at a later stage.

Taking into account the current level of financial cooperation in the EurAsEC, we believe that it would have been more profitable to create a regional capital market which would reduce dependency on foreign sources of funding. To achieve this would require the establishment of a stable, rather than a single financial market in the EurAsEC member countries.

EurAsEC and CIS countries could look to the example of Asia Pacific countries, which chose to reduce the role of foreign loans by developing a regional bond market which is less exposed to global crises.

We believe that this is a very effective mechanism which reduces exposure to currency risk and keeps resources within the region in the long term. However, there are certain obstacles to its achievement, for instance, the absence of sovereign ratings for some countries. Also, this mechanism could be launched only in a limited number of countries (Russia, Kazakhstan, Ukraine and Belarus).

Given their present status, a substantial role in the model of CIS financial markets could be played by multilateral development banks (the Eurasian Development Bank and the CIS Interstate Bank). Capital markets can be developed only through the redistribution mechanism operated by multilateral development banks (raising funds through bonds and transforming them into loans). As a result, post-Soviet countries would be able to place their funds not on the global financial markets but in the former Soviet space, helping not just to retain capital in the region but also to boost economic growth. This mechanism of developing economies and financial markets will have a wider geography (compared to the development of the bond market).

As a result, we believe that the creation of a formal common financial services market is premature. It would be more beneficial to take steps to increase stability within national financial systems, to increase their capitalisation and to develop a regional capital market.